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Supreme Court of the United States

OCTOBER TERM, 1954

No. 107

OLD MISSION PORTLAND CEMENT COMPANY
A Corporation, Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue, Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS, NINTH CIRCUIT,

AND

SUPPORTING BRIEF.

[illegible]

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Supreme Court of the United States.

OCTOBER TERM, 1934.

OLD MISSION PORTLAND CEMENT COMPANY, a Corporation, *Petitioner*,
v.
GUY T. HELVERING, as Commissioner of Internal Revenue, *Respondent.*

No.....

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS, NINTH CIRCUIT.

This is a petition for a writ of certiorari to the United States Circuit Court of Appeals, Ninth Circuit, involving a decision by that Court in the case of Old Mission Portland Cement Company, a corporation, *v.* Guy T. Helvering, as Commissioner of Internal Revenue, respondent, No. 7195, wherein that Court affirmed a decision of the United States Board of Tax Appeals, except as to one point not here involved. The Court's opinion was entered March 12, 1934 (pp. 341–355 of printed record) and the Court's judgment was entered on March 12, 1934 (R. 355–6).

QUESTIONS PRESENTED.

The case presents the following questions:

1. Did the Board of Tax Appeals, and therefore the Court, err in holding that "respondent's determination of the March 1, 1913, value of the petitioner's limestone deposits and his allowances for depletion should not be disturbed" when respondent offered no evidence to support his determination and all the evidence supported a greater value?

2. Did the Board of Tax Appeals, and therefore the Court, err in holding that respondent was not bound by his own documentary evidence as to the March 1, 1913, value of petitioner's limestone deposits?

3. When a corporation has sold bonds at a discount and is amortizing that discount over the life of the bonds in accordance with the regulations through equal annual deductions from income, is it proper to take the deduction in computing the consolidated net income of that corporation and petitioner, when petitioner is the present owner of the bonds?

4. Is a contribution by petitioner to the Community Chest of San Francisco an ordinary and necessary business expense, when petitioner's business would suffer if it refused to make the contribution?

5. Is a contribution by petitioner to a fund to support a state-wide referendum in California to increase the gasoline sales tax, for the purpose of providing funds for a twelve year road building campaign, an ordinary and necessary business expense, when petitioner is in the business of selling road material and expects to furnish part of the material used if the referendum carries?

SUMMARY STATEMENT OF THE MATTER INVOLVED.

The Old Mission Portland Cement Company, petitioner, is a corporation organized under the laws of the State of California on February 10, 1912, for the purpose of engaging in the manufacture of Portland Cement, with its principal office at San Francisco, California (R. 61). In that year, it issued part of its stock for certain limestone deposits, known as the Barbee, Underwood, and Flint, located about 88 miles south of San Francisco, together with half of the machinery necessary for the construction of a one million dollar Portland Cement plant and 2463 acres of land (R. 62).

The Commissioner of Internal Revenue determined that,

on March 1, 1913, there were 1,700,000 tons of merchantable limestone in the three said deposits suitable for the making of Portland Cement and that the fair market value thereof on that date was $63,100.00 or 3.713 cents per ton of limestone in place. In computing petitioner's income for the years here involved, he allowed depletion deductions at the rate of 3.713 cents per ton for the limestone removed and consumed in those years (R. 68). Due to the scarcity on the Pacific Coast of limestone deposits suitable for making Portland cement, petitioner claims that the said deposits had a fair market value on March 1, 1913, far in excess of that allowed by the Commissioner, and that the depletion deductions allowed by the Commissioner should be increased.

There were three expert witnesses at the trial who testified to a March 1, 1913, value for the limestone of from 78 cents to 89 cents per ton. Respondent offered no testimony in support of his valuation, but the Board held that his determination should not be disturbed and the Circuit Court approved such holding.

Although respondent introduced documentary evidence showing that the March 1, 1913, value of the said limestone deposits was 79 cents per ton (Exhibit B — pp. 303–313 of Record), by which evidence he is absolutely bound under Section 907 of Title IX of the Revenue Act of 1924, as amended by Section 1000 of the Revenue Act of 1926, and as further amended by Section 601 of the Revenue Act of 1928, the Board failed to hold that this overcame his prima facie case and that he was bound by it, and the Court approved such action.

Throughout the years involved in this proceeding, petitioner was affiliated, within the purview of the law, with the San Juan Pacific Railway Company, a California corporation, and the California Central Railroad Company, a California corporation, and the three companies rendered consolidated income tax returns (R. 76).

In 1912, the California Central Railroad Company issued its own bonds at a discount, which discount it amortized over the life of the bonds at the rate of $3,381.18 each year. During the years involved in this proceeding, petitioner owned part

of the bonds of the California Central Railroad Company. In computing the consolidated net income, respondent recognized the right of the Railroad Company to amortize and deduct the bond discount, but he disallowed that portion of it applicable to the bonds which were held by petitioner. Such disallowance was on the ground that, to the extent that the discount applied to bonds held by petitioner, it was an intercompany transaction (R. 76–7). The Board and the Court approved such action.

In each of the years 1923 to 1926, inclusive, petitioner donated $1,000.00 to the San Francisco Community Chest, this amount being the allotment assigned to petitioner by the Community Chest Committee (R. 69–72). Petitioner deducted this amount in its income tax returns for the respective years as an ordinary and necessary business expense, but respondent disallowed the deductions and the Board and the Court approved such action.

In 1926, petitioner contributed $3,000.00 to a fund to be used in a state-wide campaign on a referendum to increase the gasoline sales tax in California, in order to provide the State with badly needed funds for additional road construction and maintenance over a period of 12 years. The referendum was successful and the State embarked on an extensive road-building campaign, using large quantities of cement and cement materials, of which petitioner furnished its proportionate share (R. 71–75, 265, 267–8). Petitioner deducted the $3,000.00 so contributed as a business expense in its 1926 income tax return and respondent disallowed the deduction. The Board and the Court approved such action.

REASONS RELIED UPON FOR ALLOWANCE OF THE WRIT.

Petitioner suggests the following reasons for allowance of the writ:

1. The Board of Tax Appeals made no finding of fact as to the March 1, 1913, value of petitioner's limestone deposits. All that it did was to hold that respondent's determination "should not be disturbed" (R. 88), when all of the evidence supports a greater value.

2. Respondent determined the March 1, 1913, value of the limestone in place to be 3.713 cents per ton, but offered no evidence to substantiate such a value. He did offer evidence, however, supporting a value of 79 cents per ton and he introduced in evidence petitioner's income tax returns for the years involved in which a depletion deduction of 20 cents per ton was taken. Petitioner offered the testimony of three competent expert witnesses who testified to values ranging from 78 cents per ton to 89 cents per ton. Although this evidence stands uncontradicted and although respondent himself introduced documentary evidence substantiating a value of 79 cents per ton, the Board held that, upon consideration of all the evidence, respondent's initial determination should not be disturbed.

3. It is well established that a finding of fact by the Board of Tax Appeals based upon substantial evidence will not be disturbed. *Phillips* v. *Commissioner*, 283 U. S. 589. But it appears to be a perversion of law and justice to refuse to disturb the Commissioner's determination when there is absolutely no evidence to support it and when all of the competent and material evidence shows a much greater value.

4. The Board's decision, and therefore the Court's, is in conflict with the decision of the United States Circuit Court of Appeals, Sixth Circuit, in *James R. Duffin* v. *Lucas*, 55 Fed. (2d) 786, wherein the Court held that when the presumption of correctness of respondent is overcome, the issue must be determined by the preponderance of the evidence.

5. There is no prima facie correctness of respondent's determination of value in this case, because his determination on the face of it is wrong. He based his valuation on a royalty rate paid on an entirely different limestone deposit, as of a date other than 1913, and under entirely different circumstances. (Exhibit 1—R. 288–290.) The decisions of the Board and of the Circuit Court are therefore directly in conflict with the decision of the United States Circuit Court of Appeals, First Circuit, in *Russell* v. *Commissioner*, 45 Fed.

(2d) 100, wherein the Court held that the rule as to the prima facie correctness of the Commissioner's determination does not apply when the determination is clearly erroneous on its face. In the instant case the Board and the Court have given approval to respondent's determination of value, even though it is erroneous on its face as pointed out above.

6. The action of the Board and therefore of the Court is in direct conflict with the law and the applicable rule of evidence. Section 907 of Title IX of the Revenue Act of 1924, as amended by Section 1000 of the Revenue Act of 1926, and as further amended by Section 601 of the Revenue Act of 1928, provides:

> "The proceedings of the Board and its divisions shall be conducted in accordance with such rules of practice and procedure (other than rules of evidence) as the Board may prescribe and in accordance with the rules of evidence applicable in Courts of Equity in the District of Columbia."

Respondent introduced in evidence Exhibit B, the same being Form F filed by the taxpayer with the Bureau of Internal Revenue (set out in full at pages 303–312 of the printed Record). This document places the March 1, 1913, value of the Barbee, Underwood, and Flint deposits at 79 cents per ton of limestone in place (excluding the Gabilan deposit from consideration). This document was not offered by respondent as an admission againt interest, but even if it had been, respondent is bound by it and the Board and the Court erred in holding that he was not. In so doing, their decision is directly in conflict with the rule of evidence in Equity courts of the District of Columbia. The decision of the Board and of the Court in holding that the respondent was not bound by his own documentary evidence is in direct conflict with the holding of the Court of Appeals, District of Columbia, in *Leach* v. *Burr*, 17 App. D. C. 142, and *Lyon* v. *Bursey*, 36 App. D. C. 235, wherein the District of Columbia Court held that the party introducing documentary evidence is bound by it and can not impeach it.

7. In 1912 the California Central Railroad Company issued bonds at a discount (R. 76). Article 545 of Treasury Regulations 62 (promulgated under the Revenue Act of 1921 and applicable to the year 1923—same provision in subsequent regulations applicable to years 1924, 1925, and 1926) provides that, when bonds are issued by a corporation at a discount, the discount should be prorated or amortized over the life of the bonds and an aliquot part deducted each year. Under this provision the Railroad Company was entitled to deduct $3,381.18 each year. It did so and, in consolidating its income with that of petitioner each year, the deduction became a deduction in the consolidated return. Respondent recognized the right of the Railroad Company to deduct the discount in the years in question, but disallowed as a deduction in the consolidated return for each year the same proportion of the deduction that the bonds held by petitioner bore to the total outstanding bonds of the Railroad Company during the year (R. 76–7). The Board of Tax Appeals approved such action and the Court of Appeals affirmed the Board, although admitting that "the point is not without difficulty." (R. 373.)

If the discount charged off by the Railroad Company constituted an intercompany transaction, then of course the deduction should not be allowed in the consolidated return, provided of course that the corresponding amount of income received by petitioner is also excluded from consolidated income. But the point in the case is that petitioner did not receive any income and the deduction by the Railroad Company was not an intercompany transaction.

Because of the importance of this question in relation to affiliated corporations and in consolidated tax returns, and because of the seemingly inconsistent decisions thus far on the question, it appears that this Court should consider and decide it.

8. Petitioner contributed $1,000.00 each year to the Community Chest of San Francisco, this being the part of the total budget allocated to petitioner by the Community Chest Committee. The evidence is uncontradicted that the con-

tribution was necessary in order to maintain petitioner's good will and standing in the community and that its business would suffer and that it would be blacklisted if it did not make the contribution.

The Board of Tax Appeals disallowed the deduction without commenting upon it. The Circuit Court affirmed the Board on the ground that the contribution came clearly "within the class of contributions from which only indefinite and indirect benefit may be expected." This holding of the Court is in direct conflict with the holding of the United States Circuit Court of Appeals, Sixth Circuit, in *American Rolling Mill Company* v. *Commissioner*, 41 Fed. (2d) 314, wherein that Court said:

> "The question always is whether balancing the outlay against the benefit to be reasonably expected the business interests of the taxpayer will be advanced."

The Board's decision, and the Court's affirmance, are in direct conflict with a later decision of the Board of Tax Appeals in *The Evening Star Newspaper Company*, 28 B. T. A. 762, wherein the Board reversed its former position and held that a contribution to the Community Chest was deductible as a business expense. The Board has also allowed the deduction in other cases in which only a Memorandum Opinion was entered.

The deductibility of Community Chest donations by business corporations will be a recurring question until there are no longer any Community Chests and it will not be satisfactorily decided until passed upon by this Honorable Court.

9. In 1926 petitioner contributed $3,000.00 toward a referendum campaign carried on in the State of California to increase the gasoline sales tax in order to provide more funds to the State for road building and improvement. There can be no doubt from the record that petitioner thereby expected to increase its business and the evidence is that, in view of the success of the referendum, petitioner received its share of the new business and therefore accomplished its purpose. There

is no illegality connected with a contribution to a referendum and it can be easily understood that a 12 year road-building campaign would be beneficial to petitioner's business. The Board of Tax Appeals disallowed the deduction without comment and the Circuit Court affirmed the Board on the ground that the contribution "is not such an outlay as constitutes an ordinary and necessary business expense." In view of the Circuit Court's holding it seems proper that this Court should define, once and for all, the meaning of the words "ordinary and necessary business expense,"—especially in view of the decisions of other Circuit Courts on similar items.

See *Corning Glass Works* v. *Commissioner*, 37 Fed. (2d), 798; *American Rolling Mill Company* v. *Commissioner*, 41 Fed. (2d) 314; *The Forbes Lithograph Manufacturing Company* v. *White*, 42 Fed. (2d) 287. The spirit and intent of these decisions seem to be contrary to that of the Circuit Court in the instant case.

Wherefore, your petitioner prays that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals, Ninth Circuit, commanding that Court to certify and transmit to this Court for review and determination on a date to be therein named, a full and complete transcript of the record and of the proceedings in the case numbered and entitled on its docket No. 7195, Old Mission Portland Cement Company, a corporation, petitioner, *v.* Guy T. Helvering, as Commissioner of Internal Revenue, respondent; and that said judgment of said Circuit Court be reversed by this Honorable Court and that your petitioner have such other and further relief in the premises as to this Honorable Court may seem meet and just, and your petitioner will ever pray.

GEO. E. H. GOODNER,
Counsel for Petitioner,
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Washington, D. C.

BRIEF

IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

The opinion of the Circuit Court of Appeals, Ninth Circuit, was entered March 12, 1934, and appears in the printed record at pages 341 to 355, inclusive. The Court's judgment, entered the same day, appears at pages 355–6 of the record.

JURISDICTION.

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code, as amended by the Act of February 13, 1925, and under Section 1003 of the Revenue Act of 1926.

FACTS.

The Old Mission Portland Cement Company, petitioner, is a corporation organized under the laws of the State of California on February 10, 1912, for the purpose of engaging in the manufacture of Portland cement, with its principal office at San Francisco, California (R. 61). In that year, it issued part of its stock for certain limestone deposits located about 88 miles south of San Francisco, about half of the machinery necessary for the construction of a million dollar Portland cement plant, and 2463 acres of land (R. 62).

The corporation experienced some difficulty and delay in commencing activities, but in 1916 it began actual construction work on its plant. The mill was completed by 1918 at an additional cost of about $500,000.00 and the manufacture of cement began (R. 62). Thereafter, operations were carried on continuously by it until in 1927, when the aforesaid limestone deposits were exhausted (R. 235; Exhibit 12). The aforesaid deposits were in three separate hills or outcrops comparatively short distances apart (R. 62). They are known as the Barbee, the Underwood, and the Flint deposits (R. 61). The Commissioner of Internal Revenue determined that on March 1, 1913, there were 1,700,000 tons of merchantable limestone in the three said deposits, suitable for the making of Portland cement,

and that the fair market value thereof on that date was $63,121.00, or 3.713 cents per ton of limestone in place. In computing petitioner's income for the years here involved, he has allowed depletion deductions at the rate of 3.713 cents per ton for the limestone removed and consumed in those years as follows (R. 68):

1923	$8,973.73
1924	7,875.87
1925	9,171.74
1926	9,135.69

Due to the scarcity on the Pacific Coast of limestone suitable for making Portland cement, petitioner claims that the said deposits had a market value on March 1, 1913, far in excess of that allowed by respondent and approved by the Board.

Throughout the years involved in this proceeding, petitioner owned substantially all of the capital stock of the San Juan Pacific Railway Company, a California corporation, and this latter company owned substantially all of the stock of the California Central Railroad Company, a California corporation. Respondent has ruled that the three companies were affiliated for income tax purposes throughout the years involved in this proceeding and there is no controversy over that ruling (R. 76).

In 1912, the California Central Railroad Company issued its own bonds at a discount, which discount it amortized over the life of the bonds at the rate of $3,381.18 each year. In computing consolidated net income for the years involved here, respondent has allowed deductions in respect of such bond discount, in the amount of $375.99 for the years 1923, 1924, and 1925, and in the amount of $220.59 for the year 1926. He disallowed the balance of the amount of such amortization applicable to the years in question, because those balances were applicable to bonds held in the respective years by petitioner. In other words, respondent recognized the right of the Railroad Company to amortize and deduct that portion of its bond discount applicable to the bonds held by the public,

but disallowed as a deduction that portion of the discount applicable to the bonds owned by petitioner (R. 76–7).

In each of the years 1923 to 1926, inclusive, petitioner donated $1,000 to the San Francisco Community Chest, this amount being the allotment assigned to the petitioner by the Community Chest Committee (R. 69–72). In 1926, petitioner contributed $3,000.00 to a fund to be used in a State-wide campaign on a referendum to increase the gasoline sales tax in California, in order to provide the State with badly needed funds for additional road construction and maintenance over a period of twelve years. The referendum was successful and the State embarked on an extensive road building campaign, using large quantities of cement and cement materials of which petitioner furnished its proportionate share (R. 71, 75, 265, 267–8). In computing the net income for the respective years, respondent has not allowed any of the aforesaid amounts as deductions.

STATUTES AND REGULATIONS INVOLVED.

This case involves the following provisions of law and regulations:

Revenue Act of 1921:

> Sec. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
>
> (1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.
>
> (Sections 234 (a) (1) of the Revenue Act of 1924 and 1926 are identical.)
>
> * * * * * * * *
>
> (9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted:
>
> *Provided*, That in the case of such properties acquired prior to March 1, 1913, the fair market value of the

property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date.

Revenue Act of 1924:

Sec. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * * * * *

(8) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary.

Sec. 204.

* * * * * * * *

(b) The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be (A) the cost of such property (or, in the case of such property as is described in paragraph (1), (4), or (5), of subdivision (a), the basis as therein provided), or (B) the fair market value of such property as of March 1, 1913, whichever is greater. In determining the fair market value of stock in a corporation as of March 1, 1913, due regard shall be given to the fair market value of the assets of the corporation as of that date.

(c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property.

(The provisions of section 234 (a) (8) and 204 (b) and (c) of the Revenue Act of 1926 are identical.)

Revenue Act of 1928:

Sec. 601.

Section 906 and 907 (a) and (b) of the Revenue Act of 1924, as amended, are further amended to read as follows:

* * * * * * * *

Sec. 907 (a) * * * * * *

Hearings before the Board and its divisions shall be

open to the public, and the testimony, and, if the Board so requires, the argument shall be stenographically reported. The Board is authorized to contract (by renewal of contract or otherwise) for the reporting of such hearings, and in such contract to fix the terms and conditions under which transcripts will be supplied by the contractor to the Board and to other persons and agencies. The proceedings of the Board and its divisions shall be conducted in accordance with such rules of practice and procedure (other than rules of evidence) as the Board may prescribe and in accordance with the rules of evidence applicable in courts of equity of the District of Columbia.

Treasury Regulations 62:

Art. 545. * * * * * * *

(3) (a) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds.

(Article 545 of Treasury Regulations 65 and 69 contain the same provisions.)

Treasury Regulations 69:

Art. 635. Consolidated net income of affiliated corporations.—Subject to the provisions covering the determination of taxable net income of separate corporations, and subject further to the elimination of intercompany transactions (whether or not resulting in any profit or loss to the separate corporations), the consolidated taxable net income shall be the combined net income of the several corporations consolidated.

SPECIFICATIONS OF ERROR.

Petitioner makes the following assignments of error, which will furnish the basis of the following argument in support of the allowance of the writ:

1. The Board of Tax Appeals, and therefore the Circuit Court, erred in holding that the determination of the Commissioner of Internal Revenue as to the March 1, 1913, value of petitioner's limestone deposits should not be disturbed.

2. The Board of Tax Appeals, and therefore the Circuit Court, erred in failing to hold that respondent was bound by his own documentary evidence upon the March 1, 1913, value of petitioner's limestone deposits.

3. The Board of Tax Appeals, and therefore the Circuit Court, erred in holding that deductions by the California Central Railroad Company in amortizing the discount at which it sold its bonds, taken in computing its taxable income, are not deductible in consolidated returns of such company and petitioner, even though petitioner was the owner of the bonds.

4. The Board of Tax Appeals, and therefore the Circuit Court, erred in holding that contributions by petitioner to the San Francisco Community Chest were not ordinary and necessary business expenses.

5. The Board of Tax Appeals, and therefore the Circuit Court, erred in holding that a contribution by petitioner to the expenses of a state-wide referendum in California for increased gasoline sales taxes was not an ordinary and necessary business expense, when petitioner expected increased business as the result of a successful outcome on the referendum.

ARGUMENT.

The following argument will be based upon the foregoing assignments of error.

1. The Board of Tax Appeals, and therefore the Circuit Court, erred in holding that the determination of the Commissioner of Internal Revenue as to the March 1, 1913, value of petitioner's limestone deposits should not be disturbed.

The statutes provide for the deduction from income of a "reasonable allowance for depletion," "according to the peculiar conditions," and based on the "fair market value"

of the property on March 1, 1913. See Section 234 (a) (9) of the Revenue Act of 1921 (*supra*) which is applicable to the year 1923; Sections 234 (a) (8) and 204 (b) and (c) of the Revenue Act of 1924 (*supra*) which apply to the year 1924; and Sections 234 (a) (8) and 204 (b) and (c) of the Revenue Act of 1926 (*supra*) which apply to the years 1925 and 1926.

Respondent divided 1,700,000, the number of tons of stone, into $63,121.00, his fair market value of the property on March 1, 1913, and thereby arrived at 3.713 cents per ton in place, the depletion deduction allowed. This method of arriving at the depletion deduction is not in dispute,—only the fair market value of the deposits.

Respondent's method of arriving at the value of the $63,121.00 which he used is set out in Exhibit 1 (R. 288-294), which exhibit was offered in evidence by petitioner "solely for the purpose of showing how the Commissioner arrived at the depletion deductions" (R. 105). This exhibit constitutes the valuation report made by respondent's engineer, John Seward, and approved by his chief and adopted by respondent as his own. (See statement made in deficiency letter, R. 46.) The pertinent part of that report is as follows:

> "This case was investigated in the field according to Engineer Revenue Agent's Report of November 3, 1927. The report recommends a March 1, 1913, value of limestone of $63,121.00 based on discounting a royalty rate of ten cents per ton, which was paid by taxpayer on a contract in effect for the first time in 1920. The resulting March 1, 1913, value is further discounted by a five year deferment from 1913 to the start of quarry operations in 1918. Although the foregoing valuation is not supported by a royalty rate effective in 1913, it is recommended that it be tentatively approved, as taxpayer has been unable to submit an acceptable basis of valuation."

It is thus apparent that respondent made no attempt whatever to value the property on March 1, 1913, but, on the contrary, took a royalty rate paid for some limestone in 1920 and by discounting that in some manner arrived at his total valuation of $63,121.00. Petitioner has heard of a lessor's

value being determined by arriving at the present worth of the expected royalties to be received by said lessor; in fact, this is a very common way of arriving at the value of a lessor's interest in property. But this is the first time that petitioner ever heard of any one determining value for a property by discounting the royalty paid to some one else on an entirely different property and at a different time. Obviously respondent's basis of valuation has no merit whatever and is entirely wrong. It therefore follows that there can be no presumption of correctness thereto.

Respondent says in the above quoted paragraph that "although the foregoing valuation is not supported by a royalty rate effective in 1913, it is recommended that it be tentatively approved." This is an admission that his basis is wrong and that he failed to determine fair market value. Therefore, the presumption of correctness of his determination is overcome and the preponderance of evidence rule should prevail. *Russell* v. *Commissioner* (1 C. C. A.) 45 Fed. (2d) 100; *Duffin* v. *Lucas* (6 C. C. A.) 55 Fed. (2d) 786.

Respondent offered in evidence the 1918, 1919, 1920, and 1921 income tax returns of petitioner for the purpose of showing the income and depletion (R. 276–8). The depletion deduction taken in those returns was 10 cents per ton (R. 68). Respondent also offered in evidence Form F (Exhibit B). This Form F states that the fair market value of the limestone in the three deposits in question on March 1, 1913, was 79 cents per ton (R. 309, 311). It also states that if these deposits were combined with the Gabilan deposit and the life of the whole extended over a period of forty years or more, thus deferring the realization of income and thereby reducing the present value of it, then the total limestone in the four deposits, considered together, had a fair market value on March 1, 1913, of 20 cents per ton of stone in place. After executing and filing this Form F in December, 1922, petitioner took a deduction of 20 cents per ton in its returns filed thereafter, pending a ruling by respondent as to whether the three deposits should be valued and depleted separately or should be combined with the Gabilan deposit. Not until November, 1927, did

respondent reach a determination of value and the basis for the depletion deductions. He then decided that the three deposits, Barbee, Underwood, and Flint, should be valued and depleted separately. (Exhibit 1.) This, however, was after the income tax returns for the years here in question were filed. Therefore, on the basis of respondent's determination that the three deposits should be valued separately and on the basis of Form F (his Exhibit B, by which he is bound), the Board should have found and held without considering the evidence of petitioner's expert witnesses, that the value of the limestone in the three deposits on March 1, 1913, was 79 cents per ton.

Petitioner had three expert witnesses who testified to the March 1, 1913, value of its Barbee, Underwood, and Flint limestone deposits. The first was Mr. Ira Judson Coe, who graduated from Cornell University in 1894 with the degree C. E. Since that date, up to the date of testifying in 1931, he had been almost constantly engaged in the cement manufacturing business and the use of limestone. His early experience was in the limestone areas of the eastern portion of the United States, but in 1903 he located in California and, because of his former experiences and his qualifications, he immediately became one of the leading authorities on limestone and the cement industry on the Pacific Coast. He first saw the three limestone deposits here in question in 1904 and made a favorable report upon them at that time. He was thoroughly familiar with those deposits in 1913 and with the scarcity of limestone available for cement manufacture on the Pacific Coast, particularly in California. He was also familiar with every limestone deposit in the State which was commercially workable and, out of the wealth of his experience and knowledge gained prior to March 1, 1913, he told the Board the fair market value of those deposits on March 1, 1913, was 82 cents per ton (R. 105–163).

The next expert witness which petitioner used was Mr. Herbert Coffman, who at the time he testified was research engineer for the Hercules Cement Corporation, one of the large cement corporations in the East with headquarters in Philadelphia, and who also represented that corporation on the

Conservation Committee of the Portland Cement Association of the United States. Mr. Coffman graduated from the University of Pennsylvania in 1900 with the degree of Bachelor of Science and Chemistry. He immediately engaged in the cement business and, at the time he testified in 1931, he had had more than thirty years of actual experience in that business. He went to California in 1907 and became identified with the cement industry there. He was thoroughly acquainted with the value of limestone suitable for the making of Portland cement on the Pacific Coast and particularly in California. He knew of the properties here in question in 1913. He knew what it would cost to operate them; he knew what the market for cement was; and knew the profits that were being made. Based upon his knowledge and experience up to March 1, 1913, he told the Board that, in his opinion, the value of the Barbee, Underwood, and Flint deposits as of March 1, 1913, was 78¼ cents per ton (R. 163–186).

The third expert witness used by petitioner was Mr. F. S. Richards, one of the outstanding engineers in the cement industry to-day. In 1907, Mr. Richards completed a six-year chemical engineering course, especially designed for the cement industry, and immediately engaged in the active practice of his profession. He worked both in the United States and in Australia, and, in 1913, was thoroughly familiar with limestone conditions in the principal parts of the world. He was not in California in 1913 and did not locate there until about 1926, but, immediately upon arriving there, he made an intensive study of the particular limestone properties here in question, which had then been operating since petitioner's mill was completed in 1918. Mr. Richards delved into the early history of the property and the early history of every limestone property in California suitable for making Portland cement. Limestone suitable for this purpose was so scarce and so valuable that his services were greatly in demand by moneyed people who were attracted by the profits to be made in the manufacture of cement if suitable raw material could be found within transportation distance of an adequate market. At the time Mr. Richards testified before the Board (1931), he

probably had more accurate information through his own research, study, and investigation of the limestone and cement situation on March 1, 1913, than any other individual in the whole United States. His testimony was necessarily retrospective because he was not in California in 1913 and had not seen the particular deposits in question on March 1, 1913, but he was a witness thoroughly competent and prepared to look back into the past and express an opinion and conclusion logically drawn. If, with his technical knowledge and world-wide experience, he was not able to visualize the situation on March 1, 1913, and testify to the fair market value of the three limestone deposits in question, how could a member of the Board of Tax Appeals, who had no training at all in the limestone and cement industry and no such experience, be expected to determine the fair market value which the law requires him to do? Surely the retrospective view of one thoroughly competent and qualified, is better and more to be accepted than that of one with no experience whatever in the particular subject-matter. Mr. Richards told the Board that, in his opinion, the fair market value of the three deposits on March 1, 1913, was 89 cents per ton, and he gave the Board his reasons, as will be evidenced from a perusal of his testimony appearing on pages 186 to 271 inclusive of the printed record.

Respondent had no witnesses and offered no testimony whatever upon the March 1, 1913, value of the three deposits. He simply relied upon the presumption of correctness of his own determination. The testimony of petitioner's three expert witnesses stands absolutely uncontradicted, yet the Board member, without any experience whatever in the cement industry and without any personal knowledge of the value of limestone in California and petitioner's three deposits in particular, refused to accept it. Petitioner submits that this constitutes error on the part of the Board.

Conrad & Co. v. *Com.* (1 C. C. A.), 50 Fed. (2d) 576.
Bonwit Teller & Co. v. *Com.* (2 C. C. A.), 53 Fed. (2d) 381.
Boggs & Buhl v. *Com.* (3 C. C. A.), 34 Fed. (2d) 859.
Nichols v. *Com.* (3 C. C. A.), 44 Fed. (2d) 159.
Pittsburgh Hotels Co. (3 C. C. A.), 43 Fed. (2d) 345.

American Chemical Paint Co. v. *Com.* (3 C. C. A.), 66 Fed. (2d) 381.
Chicago Ry. Equipment Co. v. *Blair* (7 C. C. A.), 20 Fed. (2d) 10.
Planters' Operating Co. v. *Com.* (8 C. C. A.), 55 Fed. (2d) 583.
Citrus Soap Co. v. *Lucas* (9 C. C. A.), 42 Fed. (2d) 372.
Dempster Co. v. *Burnet* (D. C. App.), 46 Fed. (2d) 604.

It takes but little evidence to overcome the prima facie correctness of the Commissioner's determination. Surely the testimony of three of the outstanding authorities in the United States on the cement industry, whose testimony stands uncontradicted in the record, is sufficient to overcome the prima facie correctness of respondent's determination in this case. It is submitted that the Board's failure and refusal to so hold constitutes reversible error.

If such expert witnesses as petitioner used are not be be accredited at all, especially when they stand uncontradicted, it would seem that an appeal to the Board of Tax Appeals under the rules of evidence prescribed by statute is but a farce. Petitioner submits that the testimony of its three competent expert witnesses and the documenaary evidence which it introduced did overcome the prima facie correctness of respondent's determination and the burden of refuting that testimony became respondent's. Since he brought in no witnesses, not even his own expert engineers, it is only logical to suppose that he was not able to offer any such evidence.

It has been held that, when respondent's prima facie correct determination is shown to be erroneous, the preponderance of evidence rule prevails and that the initial presumption of correctness of the Commissioner's determination can not balance or turn the scale. *Duffin* v. *Lucas* (6 C. C. A.), 55 Fed. (2d) 786; *Russell* v. *Com.* (1 C. C. A.) 45 Fed. (2d) 100. As pointed out above, there can be no question but that petitioner's evidence overcame respondent's prima facie determination. Since he offered no evidence to support his value of 3.713 cents

per ton, it follows that the Board should have determined the value under the evidence in the record.

Respondent will doubtless lay great stress on the sheriff's sale in 1912 and argue that this indicates very little value to the limestone deposits as of March 1, 1913. The record clearly shows, however, that the sale was made at the instance of the holders of the bonds of the prior corporation who were also the principal stockholders, and that the price paid at the sale was merely the amount necessary to defray the cost of the sale; that the committee representing the bondholders bid in the property (R. 61). It must be obvious to any one that with over half a million dollars worth of machinery on the ground, as part of the property sold, those interested would not have permitted a sale at any such price as $20,700.00. So it is submitted that the sheriff's sale in 1912 is of no benefit in determining the March 1, 1913, fair market value of the property.

Respondent will doubtless argue that the property was not very valuable because of the delay in commencing operations until 1918. The record shows, however, that the stage was all set for commencement of operations back in 1906 and that it was interrupted at that time because of internal dissension among the developers. The moneyed interests then withdrew from the proposition and those retaining control could not finance it because of the panic of 1907 and the great losses sustained in the San Francisco earthquake and fire (R. 61–2). The record shows that Mr. Coffman made a careful examination of the property in 1916, and again recommended its operation as being favorable (R. 166). The actual operating history of the property is further substantiation of its worth on March 1, 1913 (Exhibit 12—R. 301).

Respondent apparently thought to discredit petitioner's case by bringing up the oyster shell deposit in San Francisco Bay. He overlooked the fact, however, that oyster shells had no value as cement material until in 1920 when machinery was first constructed to grind them successfully (R. 224–5).

Again respondent thought the fact that petitioner had purchased limestone at 10 cents per ton during some of the

years here involved would explode its contentions, but the testimony shows that the cost to petitioner of getting this 10 cent stone in excess of the cost of getting its own stone was as much as the value now claimed for its own stone (R. 233–234, 258–260).

Mr. Richards testified and Exhibit 10 (R. 298) shows that the average price of a barrel of cement in California for the 11 years preceding 1913 was $1.50 and that the average for the United States for the same period was nearly 50 cents less; that these prices interpreted in values of limestone per ton mean more than $1.00 per ton in favor of California limestone. In other words, California limestone was worth $1.00 per ton more than that of the rest of the United States during the 11 years just prior to 1913. Since the value of limestone in the eastern part of the country is only a few cents per ton, this evidence fairly checks and corroborates petitioner's contentions as to March 1, 1913, value.

The Board had the independent, unbiased opinion and judgment of three qualified experts. Each one approached the question through his own experience and arrived at the answer in a different manner or by a different formula. The variation in the answers is not great. In fact, the answers are so near together that the Board should have had very little difficulty in arriving at a value per ton which fairly approximates that contended for by petitioner.

Summing up, there is on the one hand the expert testimony of three highly qualified witnesses, corroborated by respondent's own evidence, Exhibit B, all of which proves a value of not less than 78 cents per ton. The only evidence to the contrary, if it is considered evidence at all, is the fact that petitioner took deductions at only 10 cents per ton during the first four years of its operations and 20 cents during the next four years. Surely the preponderance of evidence is decidedly in favor of petitioner and not in favor of respondent's determination of 3.713 cents per ton, to support which no evidence whatever has been introduced. It is therefore submitted that the Board was in error in holding as it did that the evidence was not sufficient to overcome the prima facie correctness of

respondent's determination and that the Circuit Court erred in affirming the Board.

2. The Board of Tax Appeals, and therefore the Circuit Court, erred in failing to hold that respondent was bound by his own documentary evidence upon the March 1, 1913, value of petitioner's limestone deposits.

There was no occasion for any determination of March 1, 1913, fair market value of the three said deposits until petitioner began to operate them and manufacture cement in 1918. In its income tax returns for the years 1918 to 1921, inclusive, petitioner took a depletion deduction of 10 cents per ton, which was purely arbitrary and not based on any definite appraisal or determination of value. However, on receipt of respondent's request for a report on the March 1, 1913, fair market value of its limestone, petitioner executed respondent's Form F (Exhibit B, pp. 301–313) for "Inorganic Nonmetallic Mineral Properties" and filed same with the Commissioner in December, 1922. In that report it set out the value of the three limestone deposits here in question at 79 cents per ton of stone in place on March 1, 1913. It stated that if these properties were thrown in with the Gabilan property so as to extend the time of full realization of the total contents to forty years or more, thus materially reducing the present worth of the whole, then the value per ton on March 1, 1913, would be 20 cents. It put it up to the Commissioner to decide whether the three deposits should be valued alone or with the Gabilan. In its 1922 tax return petitioner took a depletion deduction of 20 cents per ton on the limestone consumed and continued to take the same deduction in later years, awaiting respondent's determination as to whether depletion should be allowed on the basis of the three deposits here in question, valued separately, or on the basis of combining them with the Gabilan property. Respondent finally determined that the three deposits here in question should be valued and depleted separately, but, instead of allowing the depletion deductions at the rate of 79 cents as set out in said Form F (Exhibit B), he reduced the

value to 3.713 cents per ton and allowed that amount for the years here in question.

The general rule as to documentary evidence is stated in 22 Corpus Juris, pages 972–3 as follows:

> "A book or document offered in evidence must as a general rule be considered in its entirety, the parts operating against the interest of the party offering it as well as the parts in his favor." Citing
>
> *Butler* v. *The Arrow*, 4 F. Cas. No. 2,237, 6 McLean 470.

> "As a general rule, although a document is introduced to prove a particular fact, or for a particular purpose, it becomes substantive evidence in the cause and may be used by the adverse party for other purposes." Citing
>
> *U. S.* v. *Williams*, 18 Phillipine 291.
>
> *U. S.* v. *Diaz*, 15 Phillipine 123.

> "Where a document is introduced for the purpose of impeaching a statement of fact therein, and the party fails to so impeach it, all material facts alleged in the document are presumed to be true and the party introducing *it is bound thereby.*" Citing
>
> *U. S.* v. *Williams*, 18 Phillipine 291.

In the District of Columbia, the rule is that the party introducing documentary evidence is absolutely bound by it and can not contradict or impeach it.

> *Leach* v. *Burr*, 17 App. D. C. 142.
>
> *Lyon* v. *Bursey*, 36 App. D. C. 235.

Respondent introduced the aforesaid Form F (Exhibit B) as his evidence and not as an admission or declaration against interest (R. 280–281). Under the District of Columbia rule, he is therefore bound by it and to a value of 79 cents per ton. It was error for the board to hold otherwise.

The testimony of petitioner's three expert witnesses is directly in line with respondent's evidence in Exhibit B. Mr. Coe testified to a March 1, 1913, value per ton for the three deposits of 82 cents. Mr. Coffman testified to a value of 78 cents. And Mr. Richards testified to a value of 89 cents.

Respondent's Exhibit B (Form F) gives 79 cents. These four amounts so close together constitute not only the preponderance of evidence as to value in the case, but practically all of the evidence. The range of value, therefore, according to the evidence, is from 78 cents to 89 cents per ton. It is true that Mr. Richards' testimony is based partially upon subsequent history and, standing alone, might not be sufficient to warrant the value claimed, but when it is so near to the determination of petitioner when first called upon by respondent to fill out Form F, it must certainly be valuable as corroborative testimony, at least.

The only documentary evidence which respondent introduced bearing on the question of the 1913 value at all is Form F (Exhibit B). It is true that he introduced petitioner's income tax returns for the years 1918 to 1921, inclusive (Exhibits I, J, K, and L), in which a deduction of only 10 cents per ton for depletion was taken, but that was a purely arbitrary deduction and before petitioner was called upon to appraise its property and file Form F. Each income tax year is a period unto itself and determination of the correct income must be made regardless of any mistakes made in other years. *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 51 S. Ct. 150. These returns for 1918 to 1921, inclusive, were not offered as admissions against interest, but merely to show the income and depletion for those years. Their admission was doubtless improper but, assuming for the sake of argument that there was ground for their admission, there is no law providing that a taxpayer, having made a deduction of a certain amount for depletion in one year, is forever bound to that deduction thereafter. In the last analysis, if these returns for the years 1918 to 1921, inclusive, should be considered as evidence tending to show the 1913 value of the three limestone deposits, it must be remembered that *they are also respondent's evidence* and, under the District of Columbia rule, he would be bound by them. Therefore, even under such an extreme holding as that, the Board and the Circuit Court erred in holding that respondent was not bound by his own evidence.

3. The Board of Tax Appeals, and therefore the Circuit Court, erred in holding that deductions by the California Central Railroad Company in amortizing the discount at which it sold its bonds, taken in computing its taxable income, are not deductible in consolidated returns of such company and petitioner, even though petitioner was the owner of the bonds.

The facts in respect to this issue were found by the Board of Tax Appeals to be as follows (R. 76–77):

> "The California Central Railroad Company was organized under the laws of California in 1912, at which time it acquired in exchange for its stock and bonds all of the assets of the San Juan Pacific Railway Company, a California corporation organized prior to 1912. During the taxable years under consideration the petitioner was affiliated with the two railroad companies. The books of the three companies were kept, and consolidated income-tax returns filed, on the accrual basis.
>
> "In 1912, the California Central Railroad Company issued its own bonds at a discount. In amortizing this bond discount over the life of the bonds the amount of amortization applicable to each of the four years under consideration is $3,381.18. In computing the consolidated net income for the respective years, the Commissioner has allowed as a deduction for bond discount the sum of $375.99 in the years 1923, 1924, and 1925, and $220.79 in the year 1926. The balance applicable to each of these years, disallowed by the Commissioner, represents the amortization of bond discount applicable to bonds owned by the petitioner during these years."

The amount of bond discount amortization which respondent disallowed in each year and the amount in dispute are as follows:

1923	$3,005.19
1924	3,005.19
1925	3,005.19
1926	3,160.39

In its Opinion, wherein it sustained respondent's action, the Board did not discuss this issue but contented itself by saying (R. 89):

> "The facts of record do not distinguish the situation here presented from that ruled upon in New Orleans, Texas & Mexico Railway Co., 6 B. T. A. 436, 441, wherein we held that such bond discount was not deductible. Following that decision, the respondent's action in this particular is sustained. See also Gulf, Mobile & Northern Railroad Co., 22 B. T. A. 233, 261, wherein we followed our earlier decision on this point."

The California Central Railroad Company paid interest on its bonds held by petitioner; such interest payment was an inter-company transaction. The California Central Company deducted the amount of interest paid in its income tax return, and petitioner included that amount as income in its return. Thus, when the two returns are brought together in a consolidated return, one amount washes the other and both items are therefore eliminated. That is a typical illustration of an inter-company transaction.

But, when an item entering into the computation of income of one member of an affiliated group does not appear conversely in the income of another member, it is *not* an inter-company transaction and is *not* eliminated from the consolidated net income. Such an item was the bond discount item, which the California Central Railroad Company deducted in each of the years in question. This deduction did not represent income to petitioner because petitioner did not receive anything and made no entries whatever on its books in respect thereof. Not only were the net assets of the California Central Company reduced each year by the amount of the deduction, but likewise the total net assets of both companies together were that much less; therefore, it was not an inter-company transaction, and should be allowed as a deduction in consolidated net income just the same as any other deduction of the California Central Railroad Company, which was not income to the taxpayer. Art. 635 of Regulations 69 (*supra*).

It must be remembered that the writing off of the bond discount by the California Central Railroad Company was the amortizing of a deferred charge which it incurred through sales of its bonds years before and before petitioner was the owner of them, or any of them. This writing off is the regularly recognized and authorized method of taking care of bond discount when corporations are on the accrual basis, as in this case, and is in conformity with Treasury Department regulations. See Article 545 of Treasury Regulations No. 62, 65, and 69 (*supra*). Petitioner will realize 100 cents on the dollar at maturity for the bonds which it holds of the California Central Railroad Company, so the writing off of this loss by the California Central in no way affects petitioner. Since the California Central could not write off the total discount as the bonds were sold, to deny it the right to amortize the amount over the period, is to deny it the loss altogether.

It is not believed that respondent would have disallowed the deductions here questioned but for the Board's decision in the *New Orleans, Texas and Mexico Railroad Company* case, cited in the excerpt from the Board's opinion (*supra*). It is therefore pertinent to examine the Board's decision and the facts in that case.

An examination of that case discloses the fact that the Board did disallow the deduction for bond discount incurred under circumstances almost identical with those in the instant case, but the Board did not discuss the issue and rested its decision on the case of *Gould Coupler Company*, 5 B. T. A. 499. The latter case decided another issue altogether and furnishes no authority whatever for the position taken by the Board in the *New Orleans, Texas and Mexico Railroad Company* case.

Consideration of the *Gould Coupler Co.* case, however, is very enlightening in connection with the instant question. There the Board discussed at length the nature of consolidated income in the light of the legislative history of the provision. It sets forth the view that Congress intended consolidated income to be the income of the affiliated group as one economic unit. In the light of this discussion it appears that petitioner's contention in the instant case is sound because, if the California

Central Railroad Company and petitioner are considered as an economic unit, the unit would still be entitled to the deduction claimed.

It is therefore submitted that the Board and the Circuit Court erred in denying the bond discount deductions here in question.

4. **The Board of Tax Appeals, and therefore the Circuit Court, erred in holding that contributions by petitioner to the San Francisco Community Chest were not ordinary and necessary expenses.**
5. **The Board of Tax Appeals, and therefore the Circuit Court, erred in holding that a contribution by petitioner to the expenses of a state-wide referendum in California for increased gasoline sales taxes was not an ordinary and necessary business expense, when petitioner expected increased business as the result of a successful outcome on the referendum.**

The law involved here is Section 234 (a) (1) of the Revenue Acts of 1921, 1924, and 1926 (*supra*), providing for the allowance as deductions of all "ordinary and necessary expenses."

The Board has heretofore recognized that so-called donations are very often in fact business expenses, deductible under the provisions of the law in computing income.

Poinsett Mills, 1 B. T. A. 6;
Anniston City Land Co., 2 B. T. A. 526;
Richmond Hosiery Mills, 6 B. T. A. 1247;
Superior Pocahontas Coal Co., 7 B. T. A. 380;
Ranier Grand Co., 11 B. T. A. 520;
Hirsh-Weis Mfg. Co., 14 B. T. A. 796;
Los Angeles and Salt Lake R. R. Co., 18 B. T. A. 168;
First National Bank of Omaha, 18 B. T. A. 1358;
The Killian Co., 20 B. T. A. 80.

The Courts have also recognized the fact that the Commissioner of Internal Revenue has frequently gone too far in

disallowing business expenses on the theory that they were contributions and not deductible in computing income.

Corning Glass Works v. *Com.*, 37 Fed. (2d) 798;
American Rolling Mill Co. v. *Com.*, 41 Fed. (2d) 314;
The Forbes Lithograph Mfg. Co. v. *White*, 42 Fed. (2d) 287.

In *A. Harris & Co.* v. *Lucas* (5 C. C. A.), 48 Fed. (2d) 187, it was held that the two words "ordinary" and "necessary" are not used conjunctively and that Congress had in mind either ordinary or necessary expenses as being allowable deductions. But it matters not what construction is placed upon the phrase, in the case of business corporations, it still follows that their contributions are both very ordinary, in the sense of being of frequent occurrence, and are very necessary, if corporations expect to continue in business.

Corporations have no soul and business corporations exist for the purpose of earning profit. It can hardly be assumed that such corporations would from choice reduce their profits by making charitable donations. The logical assumption is,—and this is common knowledge among those who have engaged in business,—that corporations make their donations either to encourage and increase business, or to avoid adverse criticism and disfavor among the public which would result in a loss of business. Either purpose is bona fide and legitimate and brings the contributions within the class of ordinary business expenses.

During each of the years 1923 and 1926 inclusive, petitioner donated $1,000 to the San Francisco Community Chest. Respondent disallowed these deductions in his computation of income for the respective years and the Board approved respondent's action (R. 69, 73, 88).

Mr. Herbert Coffman, a witness on behalf of petitioner, testified that the San Francisco Community Chest was similar to organizations of that kind in the East and that, instead of having different associated charities coming around from time to time and asking for gifts and donations, they were all put into one lump sum in the Community Chest and they had one

visit a year. He stated that it was practically necessary to make these donations from a business standpoint; that they were all expected to contribute; that publicity was given to the contributions by publication of the list of contributors; that if his company, petitioner, had not been on the list, they would have been overrun with people wanting to know what was the trouble and why they had not contributed their share; that the biggest market for the output of their cement plant was in San Francisco and that it would have been a reflection upon petitioner not to have made the donations requested. When Mr. Coffman was asked if, in his opinion, a business could successfully operate without making these expenditures, he stated that he would not want to be the one to try it; that he thought it would be disastrous (R. 171–174). Mr. Coffman was sales manager of petitioner for the years 1923 to 1926 and was very intimately acquainted with the donations which petitioner made. It is always necessary for a selling organization to maintain its good will and failure to make reasonable donations for the public good is one of the quickest ways to destroy that good will. While Mr. Coffman was not personally consulted regarding these Community Chest donations and while he did not have the say as to whether or not the donations should be made, it was his business as sales manager to be intimately acquainted with the policies and activities of this company, and he was thoroughly competent to state the purpose of making the donations and what the result would have been if the donations had not been made. Mr. Coffman's testimony on this point is fully corroborated by Mr. Richards (R. 270–271).

There was a time when both respondent and the Board of Tax Appeals refused to allow donations to the Community Chest as deductions in computing income, on the theory that they were not authorized by the law. But since the decision in the instant case, the Board has reversed its position and is now allowing Community Chest donations as deductions from income upon a showing that the corporation could not afford to refuse to make the donation and would suffer from a business standpoint if it did. Such was the evidence in the instant case

and it is believed that, if the Board had this case now under consideration upon the record made, its decision would be favorable to petitioner rather than adverse.

In *The Evening Star Newspaper Co.*, 28 B. T. A. No. 762, promulgated July 7, 1933, the Board said:

> "The sole question for decision is whether the petitioner should be permitted to deduct from its gross income its contributions of the Washington Community Chest. Such a contribution when in the nature of a gift is deductible to a limited extent from the gross income of an individual. Sec. 23 (n) (2), Revenue Act of 1928. No such deduction is allowed to a corporation. But either may deduct such a contribution when it is shown that the contribution is in fact a business expense. American Rolling Mill Co. *v.* Commissioner, 41 Fed. (2d) 314; Killian Co., 20 B. T. A. 80. Since a contribution may be either a charitable gift or a business expense, a taxpayer in order to secure a deduction as a business expense must show by sufficient evidence that the expenditure had in a direct sense a reasonable relation to its business (Thomas Shoe Co., 1 B. T. A. 124) or, as said in Killian Co., *supra*, it must be 'reasonably motivated by or related to the proper conduct of the business.' See also American Rolling Mill Co. *v.* Commissioner, *supra*. Tested by these standards we think that the petitioner has shown that its contributions were ordinary and necessary expenses within the meaning of section 23 (a) of the Revenue Act of 1928. Harris & Co. *v.* Lucas, 48 Fed. (2d) 187.
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> * * * * * * * *
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> "Counsel for the respondent points out that the petitioner's witnesses were unable to show any specific gain in dollars arising from the contributions. This is an unreasonable demand. Alexander Sprunt & Son, Inc., 24 B. T. A. 599; Matson Navigation Co., 24 B. T. A. 14. It is sufficient that the directors had reasonable grounds to believe that their actions would be beneficial to the corporation. It was not necessary for them to expect additional gain. It was sufficient that they, with reasonable grounds, expected that it would prevent a loss. Kornhauser *v.* United States, 276 U. S. 145. Under either aspect we think the petitioner is entitled to the deductions claimed."

In a memorandum opinion, entered February 2, 1933, in the case of the *Killian Co.*, Docket 48053, the Board allowed as a deduction a donation made to the Community Chest of Cedar Rapids, Iowa. Since the financial depression came on and the Board's appropriation for expenses has been reduced, it has adopted the policy of entering a memorandum opinion in many cases rather than having opinions printed and published so that they can be cited in the regular way. Its decision in the *Killian Company* case, just cited, is an instance of that kind and this decision must not be confused with the former reported decision of the Board in the *Killian Company*, 20 B. T. A. 80, promulgated on June 16, 1930, which did not involve the question of deductibility of donations to the Community Chest.

As stated above, the earlier decisions of the Board were adverse to petitioner on this question, but these decisions were probably the result of failure on the part of petitioner to prove facts on which the Board could make a different holding. It is submitted that the Board reached the proper conclusion in *The Evening Star Newspaper Company, supra*, for the reasons therein stated, and that those reasons are equally applicable here. It is therefore submitted that the Board and the Circuit Court erred in refusing to allow the Community Chest donations as deductions in computing income.

In 1926, petitioner donated $3,000 to a fund to promote a State-wide referendum for an increased sales tax levy, in order that additional funds might be provided in the State of California for road building. Petitioner claimed this $3,000.00 donation as a deduction from 1926 income but respondent has disallowed it and the Board approved respondent's action (R. 69, 71, 75, 88).

The item here in question is referred to in Exhibit 16 (R. 302) as "All California Highway Lobbying, $3,000.00." Mr. Richards testified, however, that this is a misnomer, as the word "lobbying" conveys the wrong meaning. He stated that, prior to 1926, the State had a two-cent per gallon tax on gasoline, which could be used only for maintenance purposes; that it was essential, if the highway system was to be expanded and enlarged, that new roads be constructed; that the $3,000

was donated and used in a State-wide referendum campaign and that as a result of this campaign the people voted for a twelve-year road construction project. Petitioner actually pledged $10,000.00 toward this campaign but it was called upon for only $3,000.00 of the pledge. As the result of this donation and those made by other concerns, the road-building project was put under way and the State, since that time, has been spending enormous sums on the road construction; the greater part of the material used is concrete and petitioner has furnished its proportionate share (R. 265, 267–268).

Petitioner thought that a twelve year road building campaign would be extremely beneficial, or it would not have pledged $10,000.00 toward the referendum in getting the matter before the people. There can be no suggestion whatever that this $3,000.00 item was a charity; it was strictly a legitimate business expense; it was money spent with the very purpose of creating more business and it did result in much additional business. As such, it should have been allowed as a deduction from income.

CONCLUSION.

Wherefore, it is submitted that the petition for certiorari should be granted.

Respectfully submitted,

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